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SUBJECT: Argentina Economic and Financial Weekly for
the week ending March 10, 2006

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Weekly Highlights
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- The peso depreciated against the USD, closing again at 3.10 ARP/USD, reaching its lowest value in three years.
- World Bank will consider USD 3.1 billion loan to Argentina.
- Telecom agrees to suspend its ICSID arbitration claim against the GOA.
- GOA suspends beef export for 180 days
- CPI up only 0.4 percent m-o-m in February - well below market expectations of 1 percent. PPI up 1.4 percent m-o-m.
- March Consumer Confidence Index up 6.5 percent m-o-m and reaches an all-time high.
- Commentary of the Week: "INDEC's Estimates: a Methodological Obstacle?"

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MARKETS
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The peso depreciated versus the USD this week, closing at 3.10 ARP/USD - its lowest value in three years.
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¶1. The peso depreciated versus the USD this week, closing at 3.10 ARP/USD, reaching its lowest value in three years. The peso's fall this week resulted from higher dollar demand by banks, who want to dollarize their portfolios in expectation of higher U.S. interest rates, and the Central Bank's (BCRA) intervention in the FX market, where it purchased USD 169 million and EUR 17.5 million in the first four days of the week. The BCRA has purchased USD 2 billion since the beginning of the year, compared to USD 750 million during the same period last year. The peso exchange rate has depreciated 1.6 percent since the beginning of the calendar year.

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Multilateral real exchange rate appreciates 1.7 percent m-o-m in February.
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¶2. The BCRA's multilateral real exchange rate index -- measuring the real exchange rate between the peso and a trade-weighted basket of currencies -- appreciated 1.7 percent m-o-m in February. The real appreciation is mainly explained by the appreciation of the Brazilian real and dollar against the peso, partially offset by a depreciation of the Euro against the peso. The index is 2.7 percent above the level of the last twelve months and 97.8 percent above its average value during convertibility. [The BCRA's multilateral real exchange rate index weights the domestic prices and exchange rates of Argentina's main trading partners according to their share of Argentina's exports and imports.]

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ECONOMY / FINANCE
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World Bank to consider USD 3.1 billion loan to Argentina.
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¶3. After her meeting with the Minister of Economy Felisa Miceli on March 7, World Bank Vice-President for Latin America Pamela Cox said that the Bank's board will discuss the approval of a USD 3.1 billion loan to Argentina at its April meeting. This loan would fund improvements in infrastructure and social development. If approved, the loan will be disbursed over the next three years.

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Telecom agrees to suspend its ICSID arbitration claim against the GOA.
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¶4. The GOA and Telecom Argentina signed a Letter of understanding on March 6 in which France Telecom agreed to suspend its USD 297 million arbitration claim against the GOA. The claim is pending before the International Center for the Settlement of Investment Disputes (ICSID), an independent division of the World Bank. The agreement does not include any direct increase in tariffs. Like the agreement that Telefonica signed with the GOA in February, Telecom's agreement will allow it to extend for one hour the period in which it charges the highest tariff, and to triple the rates for incoming international calls. Telecom Argentina President Amadeo Vazquez also announced ARP 3 billion in investments in Argentina during the next three years. This is the twenty-fifth agreement that the GOA has closed with privatized utility companies.

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GOA suspends beef export for 180 days
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¶5. On March 8, Ministry of Economy Felisa Miceli announced that the GOA would suspend beef exports for 180 days and raise export taxes on boned cuts and heat-processed beef from 5 percent to 15 percent. The aim of these measures is to increase local supply and avoid further increases in domestic beef prices. According to GOA officials, around 600,000 tons of beef should enter the domestic market as a result of this move. Beef prices constitute 4.5 percent of the basket of goods used to measure consumer prices, and the beef sector has resisted the GOA's demands for voluntary price restraints as part of the GOA's anti-inflation effort. Beef exports to the European Union

under the Hilton quota program as well as bilateral beef-import agreements with Argentina are exempt from the suspension.

¶6. On March 9, the Argentine Rural Society (SRA) stated that the beef export ban will cost the GOA USD 600 million in lost exports. The SRA expects that Brazil and other beef producing countries will fill the gap left by Argentina, which will lose its markets in Russia, Israel, Italy, the UK, the Netherlands, Algeria, Spain and Ukraine, among others. The SRA also said that the ban will force many exporters and meatpackers into bankruptcy and result in the loss of thousands of jobs in the beef industry.

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The GOA sells USD 307 million of Boden 2012 bonds to Venezuela.
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¶7. On March 6, the GOA published in the Official Gazette a resolution authorizing the issuance of another USD 307 million worth of Boden 2012 bonds to Venezuela. This transaction is Venezuela's fourth purchase this year. The purchase brings the GOV's 2006 bond purchases to USD 1.2 billion at face value (USD 1 billion at market value).

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BCRA rolls over its maturities by accepting bids on longer-term Nobacs.
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¶8. The BCRA received ARP 1 billion in bids in its March 7 Lebac auction, less than the ARP 1.5 billion in Lebacs that came due during the week. However, the BCRA received ARP 1.2 billion in bids in its Nobac auction. [Nobacs are longer term instruments - compared to Lebacs - and pay a variable rate composed of base rate called Badlar -- the interest rate for deposits of more than ARP 1 million, currently at 7 percent -- plus a spread. The BCRA auctions the spread on its Nobacs, while the Badlar is determined by market conditions.] As in previous auctions, the BCRA was more than able to roll over its maturities by accepting bids for ARP 2.0 billion (ARP 1 billion in Lebacs and ARP 966 million in Nobacs). The yield on the 42-day Lebac and the 98-day Lebac remained unchanged at 6.75 percent and 7.25 percent, respectively. The yield on the 70-day Lebac decreased slightly from 6.97 percent to 6.95 percent, while the yield on the 182-day Lebac reached 8.25 percent. Lebacs for other maturities were withdrawn due to lack of interest. Investors concentrated more than 53 percent of their bids in Nobacs of more than 9 months and the BCRA accepted bids for ARP 966 million of Nobacs (48 percent of the accepted amount in the auction). The spread on the nine-month Nobac decreased three basis points, from 3.12 percent to 3.09 percent, while the spread on the two-year Nobac dropped 29 basis points from 5.40 percent to 5.11 percent. Investors are increasing their bids in Nobacs, since these instruments have a variable rate and provide a higher yield (10.9 percent and 12.9 percent for the 9-month and 2-year Nobac, respectively). In the first two auctions this month, the BCRA was able to roll over more than half of the ARP 5.7 billion maturities coming due in March.

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GOA closes a price-restraint agreement with the CNG sector.
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¶9. As anticipated in last week's Financial Weekly, the GOA signed an agreement with the Compressed Natural Gas (CNG) retail sector on March 8. This new price-restraint agreement aims to freeze the price of

CNG until the end of the year. However, the accord is subject to bi-monthly monitoring of any changes in costs.

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CPI up only 0.4 percent m-o-m in February - well below market expectations of 1 percent. PPI up 1.4 percent m-o-m.
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¶10. The CPI increased 0.4 percent m-o-m in February, well below market expectations of 1 percent and far below the 1.3 percent m-o-m increase in January. CPI core inflation was 0.5 percent, but was offset by a 0.1 percent fall in the seasonal component. The monthly rise was driven mainly by an increase in the prices of health (+1 percent) and food and beverages (+1 percent, despite price-restraint agreements between the GOA and many producers and retailers), but these increases were offset by a fall in clothing (-2.1 percent) and leisure activities (-1.0 percent) both of which are due to seasonal factors. Year-over-year, the CPI is up 11.5 percent. The BCRA consensus survey forecasts 12.5 percent inflation in 2006, down slightly from 12.7 percent forecast last month, and reflecting a slight fall in inflation expectations. The GOA has now signed price restrain agreements with many sectors of the economy including foods and beverages, apparel, school supplies, toiletries, physicians fees, and hotels. The 2006 Budget projects 9.1 percent inflation rate for 2006 and the Central Bank's inflation target range is 8-11 percent.

¶11. Producer prices increased 1.4 percent m-o-m in February, due to a 0.6 percent rise in the prices for manufactured goods and electricity and a 3.3 percent increase for primary goods prices. The price of electric energy rose 1.1 percent. Imported goods prices increased 1.4 percent. The PPI index increased 13.5 percent y-o-y.

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March Consumer Confidence Index up 6.5 percent m-o-m and reaches its all- time high.
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¶12. The Consumer Confidence Index -- published by Universidad T. Di Tella -- jumped 6.5 percent m-o-m in March, reaching its all-time high of 59.9 points. The March increase came in consumer's willingness to purchase durable goods and real estate (+7.5 percent m-o-m) and consumer's sentiment towards the macroeconomic environment (+7.3 percent m-o-m), followed by positive expectations on individual's personal situation (+4.9 percent m-o-m). The index increased 2.6 percent y-o-y. The index is based on surveys of individual economic sentiment and consumer willingness to purchase durable goods, houses and cars.

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Commentary of the Week: "INDEC's Measurements: A Methodological Obstacle?" by SEL Consultores, February ¶2006. [Note: Translated and used with permission of the author. End Note.]
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¶13. The Economy Minister's reaction to an announcement by the official statistics bureau (INDEC) of increase in the income gap between the richest and the poorest during the third quarter of 2005 was to claim that INDEC's calculation methodology was incomplete. Felisa Miceli's argument is that INDEC's methodology "does not include all the efforts made by the Government to improve income distribution; it only takes into account monetary income . numbers that show monetary inequalities are softened if you take social expenditures into account, which have increased

significantly since May 2003 and continue to rise."

¶14. The Minister is right when she emphasizes the redistributive effect of public social expenditures. Free access (that is, access financed by budgetary resources) to education, health care, or nutrition programs - to name the most relevant - have a significant impact on the welfare of low income households although, unlike other programs such as Heads of Households, they are not recorded as monetary income. Consolidated public expenditures that are mainly directed to low income households (elementary education, public health care, and public social promotion and assistance) totaled more than ARP 26.5 billon in 2004. In 2005, they must have reached ARP 30 billion. Assuming that what reaches the poor is equal to the percentage of all consumers of these services that live in the 30 percent of households with the lowest per capita family income level, one can estimate a gross transfer-in-kind (not counting administrative bureaucratic expenditures) of around ARP 20.6 billion for 2005. This suggests an unregistered, gross redistributive impact on monetary income of around ARP130 per month. Obviously, if this value is imputed, as Minister Miceli suggests it should, the gap between the rich and the poor would be substantially smaller.

¶15. Up to this point, Minister Miceli is correct. But she is wrong in about two principal issues.

¶16. Firstly, public expenditure has a redistributive effect not only in favor of the poorest, but also in favor of those who aren't so poor, and even to the richest. The most obvious case of this is public university education. 85 percent of public university students belong to households that are above the poverty line. Moreover, the percentage of public university students who are from the richest 10 percent of households (whose income, according to INDEC's latest report, is 31 times above the income of the poorest 10 percent) is equal to the percentage of students coming from all poor households. The 2005 budget for public universities was ARP 26 billion; the portion of that which benefited students from the richest third of the population equals the federal government's total expenditures on programs for nutritional assistance, maternal-infant healthcare, distribution of medicines, social promotion, emergency assistance, and compensatory education action. The 2005 budget for this last program, which provides school supplies, books and scholarships for children and youngsters from disadvantaged socio-economic conditions, was ARP 268 million; public university expenditures that benefited students from the richest 10 percent households were ARP 382 million.

¶17. Secondly, social public expenditures on non-monetary transfers targeted mainly to low income households -- the State's major effort to meet social needs -- are still noticeably less than they were during the crisis period 1998-2001, and even less than the average expenditures during the 1990s. In 2004 - the latest data available - consolidated public spending on basic education, public health care, and public social assistance and promotion was, in constant prices, 20 percent below levels of 1998-2001, and 5 percent below the 1991-2001 average. The source for these figures is the Ministry of Economy. If you adjust these figures for the incidence of poverty (it was 29 percent in 1991-2001, 5 points less than it is now), the in-kind social expenditure gap would be even larger. This suggests that if one were to impute non-monetary transfers to the entire statistical series, inequality would not diminish, but in fact would increase.

¶18. This is more than a "methodological vice." The

cause of persistent high levels of income inequality is the segmentation of the labor market, and particularly in the disparity in the evolution of formal and informal salaries. The salary gap between these segments grew by almost 12 percent in 2005 (it had been stable in 2004). At the same time, job creation was cut in half (to 4.5 percent from 8.4 percent in 2004) and was almost zero in the informal sector. Finally, unemployment in the informal sector continues to be very high (around 20 percent) while the formal sector is experiencing almost full employment. The combination of these factors has caused incomes in the lowest deciles, where informal labor mainly is found, to grow more slowly than incomes in the medium and high deciles, where formal labor is concentrated. The key to improving distributive equity therefore is reducing the dual nature of the labor market, as well as re-orienting social public spending. [Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.]

¶19. To see more Buenos Aires reporting, visit our classified website at:
http://www.state.sgov.gov/p/wha/buenosaires

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